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No. _____

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1997

MILTON BARNES,

Petitioner,

vs.

MARTIN LOGAN;
KOREN LOGAN,
Trustees for the Logan
Inter Vivos Trust,

Respondents.

**PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT**

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## QUESTION PRESENTED

Are individual stockbrokers entitled to due process review of punishments imposed upon them through punitive damages awards in securities arbitrations?

## PARTIES TO THE PROCEEDING

All of the parties in the Court of Appeals are identified in the caption. In addition, the following persons were parties in the district court, but did not enter an appearance in the Court of Appeals in this case: John G. Kinnard & Company, Inc. and Scott Grady.

Milton Barnes petitions for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

## OPINIONS BELOW

The opinion of the Court of Appeals (Appendix B) is reported at 122 F.3d 820. The memorandum and order of the District Court (Appendix C) is not reported in the Federal Supplement, and is cited as 1996 WL 310115 (N.D. Cal., May 29, 1996).

## JURISDICTION

The judgment of the Court of Appeals was entered on August 20, 1997. A petition for rehearing was denied on September 12, 1997 (Appendix A). The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254.

## STATUTES INVOLVED

The pertinent statutes are set forth at Appendix G.

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## STATEMENT

### A. Background

At issue is the due process adequacy of judicial review of a punitive damages award made by a National Association of Securities Dealers arbitration panel. In *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 107 S. Ct. 2332, 96 L. Ed. 2d 185 (1987), this Court emphasized the supervisory role that the Securities and Exchange Commission has in NASD arbitrations pursuant to a delegation of congressional authority:

> In 1953 . . . the Commission had only limited authority over the rules governing self-regulatory organizations (SROs) -- the national securities exchanges and registered securities associations -- and this authority appears not to have included any authority at all over their arbitration rules. Since the 1975 amendments to § 19 of the Exchange Act, however, the Commission has had expansive power to ensure the adequacy of the arbitration procedures employed by the SROs. No proposed rule change may take effect unless the SEC finds that the proposed rule is consistent with the requirements of the Exchange Act, 15 U.S.C. § 78s(b)(2); and the Commission has the power, on its own initiative, to "abrogate, add to, and delete from" any SRO rule if it finds such changes necessary or appropriate to further the objectives of

> the Act, 15 U.S.C. § 78s(c). In short, the Commission has broad authority to oversee and to regulate the rules adopted by the SROs relating to customer disputes, including the power to mandate the adoption of any rules it deems necessary to ensure that arbitration procedures adequately protect statutory rights.

*Id.* at 233-34, 107 S. Ct. at 2341 (citation omitted; footnote omitted).

As a condition of becoming a stockbroker, Mr. Barnes was required to participate in any NASD arbitration commenced by a customer. Jaffe, "Broker-Dealers and Securities, A Guide to the Regulatory Process," §§ 2.05, 3.13, pp. 23, 50 (1977). The U-4 form which he was required to sign as a condition of employment provides:

> 5. I agree to arbitrate any dispute, claim or controversy that may arise between me and my firm, or a customer, or any other person, that is required to be arbitrated under the rules, constitutions, or by-laws of the organizations indicated in Item 10 as may be amended from time to time and that any arbitration award rendered against me may be entered as a judgement in any court of competent jurisdiction.

NASD Manual -- Administrative (CCH), p. 476 (1997). This agreement to arbitrate any customer claim at the insistence of the customer is reiterated at NASD Code of

Arbitration Procedure Rule 10301 and NASD Code of Arbitration Procedure Rule 10314(B) (NASD Manual -- Code of Arbitration Procedure (CCH), pp. 7571, 7577). Neither the rules, constitution or any bylaws of the NASD mention the term "punitive damages," nor does the U-4 form contain any indication that by signing it, a stockbroker waives his rights to due process review. By contrast, the NASD, as a registered association of securities broker/dealers, when enforcing members' compliance with applicable rules and regulations, is required to "provide a fair procedure for the disciplining of members and persons associated with members," including specified penalties designed to provide an appropriate sanction for specified types of misconduct. See generally, NASD Sanction Guidelines (1996). 15 U.S.C. § 78*o*-3(b)(8). Thus, the NASD provides for a hearing and a multi-stage review process for disciplinary proceedings, which is ultimately subject to SEC review, NASD Code of Procedure Rules and Rule 9370 (NASD Manual -- Code of Procedure (CCH), pp. 7337 *et seq.* and p. 7374); 15 U.S.C. § 78y(a); and final review by the United States Court of Appeals.

### B. The Logans' Customer Complaint

Martin Logan and his wife had been customers of Milton Barnes beginning in 1989. They followed him from the brokerage firm of Bateman Eichler Hill Richards, Inc. to PaineWebber, and then to the Phoenix office of John G. Kinnard & Company, Inc., a brokerage firm based in Minneapolis, Minnesota. During the early years, the Logans specified an aggressive investment strategy, and during the early years, the account increased remarkably in value. Only after the account began to decline in 1994 did the Logans complain. In December 1994, the Logans initiated an NASD arbitration claim against Barnes, John G. Kinnard & Company and Scott Grady, Kinnard's branch manager.

In October 1995, the NASD conducted a four-day arbitration hearing in San Francisco. The three-arbitrator panel was comprised of one lawyer and two lay people.[1] The panel requested briefs on the parties' positions on punitive damages. In his, Barnes argued that no punitive damages were possible under California law, because the California Supreme Court in *Adams v. Murakami*, 284 Cal. Rptr. 318, 813 P.2d 1348, 1351 (1991), ruled that California law requires a plaintiff to introduce evidence of a defendant's net worth before an award of punitive damages can be made or sustained on appeal. Although some evidence was offered at the arbitration concerning Mr. Barnes' income, the plaintiffs did not offer evidence of his net worth. The arbitration panel made its decision in January 1996 (Appendix D). It awarded the Logans compensatory damages of $262,000 and $27,000 in interest jointly against John G. Kinnard & Company, Mr. Grady and Mr. Barnes. The panel also awarded punitive damages of $250,000 against Mr. Barnes and punitive damages of $500,000 against John G. Kinnard & Company. In the award, the panel specifically stated that the punitive damages award was based on California Civil Code § 3294.

### C. Court Procedures to Confirm or Vacate the Award

Under the Federal Arbitration Act, 9 U.S.C. § 10, Mr. Barnes initiated an action in the United States District Court for the Northern District of California seeking to vacate the arbitration award. The Logans counterclaimed, asking that the award be confirmed. The district court entered

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[1] Under the NASD Code of Arbitration, there is no requirement that any panelist be a lawyer. NASD Manual -- Code of Arbitration Procedure, Rules 10104 and 10308 (CCH), pp. 7512 and 7574.

judgment for the Logans on June 21, 1996. Mr. Barnes appealed.

In reliance on *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 109 S. Ct. 1248, 103 L. Ed. 2d 488 (1989), the Ninth Circuit ruled, under the arbitration agreement, "the substantive law of Minnesota governs the availability of punitive damages." 122 F.3d at 822. The Court of Appeals went on to say that the arbitrators "acted beyond their authority and the applicable law in awarding punitive damages under California law, because the parties clearly had chosen Minnesota law as the governing law." *Id.* at 823.

Turning then to Minnesota law, the Court of Appeals noted that there is a conflict in different divisions of the Minnesota Court of Appeals about whether the Minnesota Supreme Court's decision in *Independent Sch. Dist. No. 622 v. Keen Corp.*, 511 N.W.2d 728, 732 (Minn. 1994), prohibits punitive damages in cases which do not involve personal injury. *Soucek v. Banham*, 524 N.W.2d 478, 480 (Minn. Ct. App. 1994), appears to bar punitive damages, whereas *Molenaar v. United Cattle Co.*, 553 N.W.2d 424, 428 (Minn. Ct. App. 1996), suggests that punitive damages should be allowed for deliberate disregard of rights, including for fraud. 122 F.3d at 823.

The Ninth Circuit agreed that in normal circumstances it would be required to decide whether punitive damages were available under Minnesota law for the types of claims made by the Logans against Mr. Barnes, but it held that it did not need to do so because the applicable standard of review under the FAA is "manifest disregard of law":

> Ordinarily, when we are faced with two conflicting decisions from a state's intermediate appellate courts, such as *Soucek* and *Molenaar*, "this Court must determine what decision the highest court [of the state] would reach if faced with the issue." [Citation omitted.] In this case, however, we need not engage in that analysis because the issue before us is not, precisely, what the Minnesota law of punitive damages is, but whether the arbitrators acted in manifest disregard of Minnesota law in awarding punitive damages.

*Id.*

Under the manifest disregard standard, the Ninth Circuit held, "we cannot conclude that the arbitrators acted in manifest disregard of Minnesota law in awarding punitive damages." *Id.* It further held that because, under a manifest disregard standard, a punitive damages award for fraud under Minnesota law would not be overturned, and that "the arbitrators' error in referencing California law in awarding punitive damages was harmless." *Id.* at 824. Despite the fact that the arbitrators had applied the wrong law and had applied it incorrectly, the Ninth Circuit therefore refused to vacate and remand the arbitrators' punitive damages award.

### D. Other Related Punishments

The NASD has notified Mr. Barnes that his failure to pay the Logans' $250,000 punitive damages award will result in the cancellation of his NASD registration pursuant

to Article VI, Section 3 of the NASD By-Laws. NASD Manual -- By-Laws (CCH), p. 1054 (October 8, 1997 letter, Appendix E).

In addition, Mr. Barnes is the subject of NASD disciplinary proceeding, No. C3A960030 concerning the same securities transactions in the Logans' accounts. (A copy of the Statement of Complaint is Appendix F.)

## REASONS FOR GRANTING THE PETITION

### A. The Ninth Circuit's Decision Is in Conflict with the Decisions of this Court Requiring Meaningful Judicial Scrutiny of Punitive Damages Awards

#### 1. History

We recognize that in earlier stages of judicial enthusiasm for arbitration, arbitrators have been given essentially unlimited license and have been subject to no effective review at all. *See, e.g., United Steelworkers of America v. Enterprise Wheel & Car Corp.*, 363 U.S. 593, 80 S. Ct. 1358, 4 L. Ed. 2d 1424 (1960). But, this Court has been on a clear contrary course developing the doctrine of due process with special reference to punitive damages where the potential for unlicensed abuse is so great. This trend began with *Pacific Mutual Life Ins. Co. v. Haslip*, 499 U.S. 1, 111 S. Ct. 1032, 113 L. Ed. 2d 1 (1991). There, the majority held that due process review of punitive damages awards is constitutionally required: "[W]e conclude that our task today is to determine whether the Due Process Clause renders the punitive damages award in this case constitutionally unacceptable." *Id.* at 18, 111 S. Ct. at 1043. Noting its "concern about punitive damages that 'run wild,'" *id.*, the majority found that unlimited

discretion in the imposition of punitive damages, even in the hands of a judge, is constitutionally unacceptable:

> One must concede that the unlimited jury discretion -- or unlimited judicial discretion for that matter -- in the fixing of punitive damages may invite extreme results that jar one's constitutional sensibilities.

*Id.* We appreciate that in *Haslip* the due process test was held to have been achieved. The vital matter is the holding that there is a due process test, a heightened scrutiny of punitive damages awards is required and there must be a reasoned thought process not only in the award but in the review of the award.

Next, in *TXO Production Corp. v. Alliance Resources Corp.*, 509 U.S. 443, 113 S. Ct. 2711, 125 L. Ed. 2d 366 (1993), the court produced five separate opinions, none of them a majority opinion. A majority of the justices, however, reaffirmed that the due process clause requires judicial review of punitive damages awards. *Id.* at 466-69, 113 S. Ct. at 2724-26; *id.* at 470-72, 113 S. Ct. at 2726-28; *id.* at 472-501, 113 S. Ct. at 2728-42.

In *Honda Motor Co., Ltd. v. Oberg*, 512 U.S. 415, 114 S. Ct. 2331, 2333, 129 L. Ed. 2d 336 (1994) this Court, concerned that "[p]unitive damages pose an acute danger of arbitrary deprivation of property," struck down a long-standing Oregon constitutional prohibition against judicial review of the size of punitive damages awards. The Court rejected Oberg's contention that the trial court's jury instructions in the case contained "substantive criteria that provide at least as much guidance to the factfinders as the

Alabama statute and jury instructions" the Supreme Court upheld in *Haslip*. 512 U.S. at 418-19, 114 S. Ct. at 2334. It did so because, under the Oregon constitution, there was no judicial review to determine whether those instructions had, in fact, been followed. *Id.* In the Court's words:

> The problem that concerns us, however, is the possibility that a jury will not follow those instructions and may return a lawless, biased, or arbitrary verdict.

*Id.* at 433, 114 S. Ct. at 2341. Finding that the decision whether to impose punitive damages "should not be committed to the unreviewable discretion of a jury," this Court struck down the Oregon constitutional prohibition. *Id.* at 435, 114 S. Ct. at 2342.

### 2. The Direct Conflict

The decision of the Ninth Circuit below is in direct conflict with the reasoning of this Court in *Haslip* and the Court's holding in *Honda Motor Company*. This case is particularly apt, because in it, the Ninth Circuit demonstrably bypassed systems set up by two separate states, California and Minnesota, to assure adequate due process review of punitive damages awards. In doing so, it also demonstrated a fact that is not quite self-evident: Review under a manifest disregard of law test is tantamount to no review at all.

### 3. The California and Minnesota Due Process Requirements

*Adams v. Murakami*, 284 Cal. Rptr. 318, 813 P.2d 1348 (1991), an *en banc* decision, represents California's first

major attempt to assure compliance with the due process concerns this Court expressed in *Haslip*. 813 P.2d at 1355-56. In reversing a $750,000 punitive damages award because the plaintiff had presented no evidence of the defendant's financial condition, the court found that the consideration of a defendant's financial condition is necessary to determine how much a particular punitive award would punish the defendant in question. Quoting the Alabama Supreme Court with approval from *Green Oil Co. v. Hornsby*, 539 So. 2d 218, 223 (Ala. 1989), it said:

> What (i.e., how much) will it take to punish *this* Defendant? . . . The gravity of the wrong may be the same, whether the defendant is a salaried employee or a multimillion dollar corporation, but, in the case of the former, the $220,000 verdict would be far out of proportion to its intended purpose. What it takes to punish the one bears no relationship to what it takes to punish the other.

813 P.2d at 1356. Although it did not reach the question of whether evidence of a defendant's financial condition is a constitutional prerequisite under *Haslip*, the California Supreme Court noted that "[a]t a minimum, however, the high court has made clear a constitutional mandate for meaningful judicial scrutiny of punitive damages awards." *Id.* It is just such meaningful scrutiny that the Ninth Circuit refused to apply.

Minnesota, too, has concluded that "because of the open-ended and volatile nature of punitive damages, appellate courts must exercise 'close control over the imposition and assessment of punitive damages.'" *Bradley v. Hubbard*

*Broadcasting, Inc.*, 471 N.W.2d 670, 679 (Minn. Ct. App. 1991), *quoting Hodder v. Goodyear Tire & Rubber Co.*, 426 N.W.2d 826, 835 (Minn. 1988), *cert. denied*, 492 U.S. 926 (1989). In Minnesota there is a statute, Minn. Stat. § 549.20 subd. 3, designed "to permit greater trial and appellate court scrutiny of punitive damages," which "is significantly more detailed than the Alabama statute that passed scrutiny in *Pacific Mutual.*" *Bradley*, 471 N.W.2d at 678.

In addition to the controversy over whether Minnesota law permits punitive damages in cases which do not involve physical injury, discussed in *Barnes v. Logan*, 122 F.3d 820, and at p. 5 *supra*, Minnesota Statute § 549.20 subd. 3 (1990) requires consideration of "the financial condition of the defendant and the total effect of other punishments likely to be imposed on the defendant as a result of the misconduct . . . ."[n2]

The California and Minnesota statutes are not two peas in a pod.[3] Under a due process standard of close judicial

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[2] Mr. Barnes is presently the subject of an NASD disciplinary proceeding in which he could be fined up to $50,000 plus return of commissions and barred permanently from the securities industry. See NASD Sanction Guidelines (1996), p. 10.

[3] For example, California Civil Code § 3294 requires clear and convincing evidence that enumerated conduct occurred; Minnesota requires clear and convincing evidence not just that the enumerated conduct occurred but, in addition, that the defendant "has knowledge of facts or intentionally disregards facts that create a high probability of injury to the rights of others." Minn. Stat. § 549.20 subd. 3. California, on the other hand, focuses upon

scrutiny, the punitive damages award should have, without doubt, been vacated and the case remanded for consideration under the due process criteria embodied in Minnesota's punitive damages statutes.

### 4. "Manifest Disregard," a Standard Tantamount to No Review

Instead, the Ninth Circuit made its review under the "manifest disregard of law" standard of 9 U.S.C. § 10, the Federal Arbitration Act. Under this standard, the court found that (1) it did not even need to reach the question of whether punitive damages were available in the absence of personal injury under Minnesota law and (2) that the panel's erroneous application of California law was "harmless." *Barnes*, 122 F.3d at 824.

If it could do this, the "manifest disregard" standard is tantamount to no standard at all. Under it, courts must confirm arbitration awards even where they are attributable to "'erroneous findings of fact or misrepresentations of law.'" *French v. Merrill Lynch, Pierce, Fenner & Smith*, 784 F.2d 902, 906 (6th Cir. 1986), *quoting American Postal Workers Union, AFL-CIO v. United States Postal Serv.*, 682 F.2d 1280, 1285 (9th Cir. 1982), *cert. denied*, 459 U.S. 1200 (1983). "It is not even enough that the

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whether the defendant has been guilty of (among other things) "malice," a concept which Section 3294 of the California Civil Code subd.(c)(1) describes as including "despicable conduct." Thus, by applying the California statute, then following the California statute, California could have concluded that punitive damages were appropriate due to "despicable conduct" without ever finding the "high probability" of injury required in Minnesota.

Panel [of arbitrators] may have failed to understand or apply the law. . . . An arbitrator's decision must be upheld unless it is 'completely irrational,' or it constitutes a 'manifest disregard of the law.'" *French*, 784 F.2d at 906. In *Michigan Mut. Ins. Co. v. Unigard Sec. Ins. Co.*, 44 F.3d 826, 832 (9th Cir. 1995), the Ninth Circuit explained that "manifest disregard of the law" means:

> something more than just an error in the law or a failure on the part of the arbitrators to understand or apply the law. It must be clear from the record that the arbitrators recognized the applicable law and then ignored it.

(Citations omitted.) *See also San Martine Compania de Navegacion, S.A. v. Saguenay Terminals Ltd.*, 293 F.2d 796, 801 (9th Cir. 1961) ("manifest disregard of the law" might be present authorizing vacation or setting aside of an arbitrators' award when the arbitrators understand and correctly state the law but proceed to disregard it); *Carte Blanche (Singapore) Pte., Ltd. v. Carte Blanche Int'l, Ltd.*, 888 F.2d 260, 265 (2d Cir. 1989) ("manifest disregard of the law" by arbitrators is a judicially created ground for vacating arbitration awards, and refers to error which was obvious and capable of being readily and instantly perceived by an average person qualified to serve as an arbitrator; the doctrine implies that the arbitrator appreciates the existence of clearly governing legal principle but decides to ignore it or not pay attention to it).

The standard is virtually illusory. Under it, an arbitration panel can avoid review simply by failing to communicate that (1) it knew the correct law, and (2) chose to ignore it. Mr. Barnes' memorandum to the panel argued that the case was controlled by Minnesota law, but there

was no manifest disregard according to the Ninth Circuit, because the arbitration panel did not explicitly acknowledge that it understood that Minnesota law applied but chose to disregard it. 122 F.3d at 823-24. Small wonder that 9 U.S.C. § 10 n.11 (manifest disregard of law) reports no cases overturned on the grounds of manifest disregard of the law (1970 and 1997 Supplement). Similarly, the Uniform Arbitration Act (ULA) § 12 n.151 (manifest disregard of agreement or law) (Vol. 7 1997) reveals no cases where an arbitration award was vacated or remanded on the basis of manifest disregard of the law.

### 5. The *Todd Shipyards* Evasion

In its opinion below, the Ninth Circuit made no effort to justify its decision under the Due Process Clause. In this, it is at odds with *Glennon v. Dean Witter Reynolds, Inc.*, 83 F.3d 132, 139 (6th Cir. 1996), which assumed, albeit without deciding, that punitive damages awards rendered by arbitrators are subject to due process review (but which found no denial of due process on the unique facts of the case).

Instead, relying on *Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056 (9th Cir. 1991), the Ninth Circuit held that Mr. Barnes had waived his right to due process review when he had agreed to arbitration.[4] *Todd Shipyards*

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[4] *In dicta* the Ninth Circuit also suggested that since the punitive damages award of $250,000 awarded against Mr. Barnes was less than the $262,000 in compensatory damages for which he was made jointly liable, the award was not "grossly excessive." 122 F.3d at 824. As pointed out in *Adams v. Murakami, supra*, this type of reasoning may make sense when the defendant is a multimillion dollar corporation, but it does not adequately assess the punitive

is distinguishable because it involved two large companies who, being fully informed actually did agree, through a negotiated contract, that all their claims against one another would be resolved through AAA arbitration. By contrast, Mr. Barnes was required to sign a U-4 as a condition of his employment, and nothing in the text of the U-4 or the rules of the NASD suggest that he could be subject to severe financial sanctions through arbitration -- as opposed to the due process review provided through the NASD's normal disciplinary channels -- without any right to meaningful review of any monetary punishment awarded against him. He was not told, and could not know, that by signing a U-4 he was signing away his constitutional rights as an American citizen.

Alternatively, if *Todd Shipyards* is read as allowing arbitrators to trample due process rights, we respectfully suggest: it was wrongly decided. As intended by the founders, this Court should announce that no American citizen will be subjected to potentially ruinous financial punishments through a government sanctioned[5] dispute

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impact on an individual defendant. See discussion of *Adams v. Murakami* at pp. 9-10. In reality, a nondischargeable punitive damages award accruing interest may effectively constitute a sentence to a life of impoverishment.

[5] The Logans may attempt to alternatively argue that NASD arbitrations do not involve "state action." As applied to the NASD, this position is not plausible. In order to be a stockbroker, federal law required that Mr. Barnes join the NASD, and all NASD organic documents, rules and regulations are subject to SEC approval and can be changed by the SEC at its discretion. According to these SEC approved rules, if Mr. Barnes does not pay the

resolution process without the protection of due process review.

### B. This Court's Intervention Is Needed, Now, to Provide Further Guidance for the Arbitration of Securities' Claims

The privatization of dispute resolution is a burgeoning phenomenon. In the words of Joyce Luther Kennard, Associate Justice of the California Supreme Court, "Today, arbitration has spread to every major commercial context . . . if you go to the bank or the doctor, or make a purchase or take a new job, there is a good chance you will run into

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award against him, the NASD will revoke his membership, which in turn will cancel his license with the SEC and thereby conclude his career as a stockbroker. See discussion p. 2 *supra*. *Shearson/American Express*, 482 U.S. at 234, 107 S. Ct. at 2341. Indeed, it is the SEC's approval of rules which do not require a due process review mechanism for arbitration awards, similar to those of the NASD disciplinary procedures, that has created the constitutional question posed by the case at bar. Furthermore, in order to make the arbitration award final and collectible, it must be confirmed by the federal district court. 9 U.S.C. § 9. In short, the government has created the legal framework governing the conduct of the NASD and has engaged in state action by its delegation of authority to the NASD. *See West v. Atkins*, 487 U.S. 42, 108 S. Ct. 2250, 101 L. Ed. 2d 40 (1988) (state may delegate authority to a private party and thereby make that party a state actor); *see also National Collegiate Athletic Ass'n v. Tarkanian*, 488 U.S. 179, 193-94, 109 S. Ct. 454, 462-63, 102 L. Ed. 2d 469 (1988) (finding no state action by the NCAA: only because "no official authority has been conferred on it by any government . . .").

an arbitration agreement." Remarks of Joyce Luther Kennard at National Conference of Commissioners on Uniform State Laws, quoted by Michael Yablonski in "Conference Considers Overhaul of Arbitration Act," Litigation News, Vol. 22, No. 6, p. 6 (September 1997). The American Arbitration Association reports that its "overall case load rose to a record 70,516 cases, an increase of about 13% year to year . . . ." American Arbitration Association Annual Report 1996, p. 5. The Securities Arbitration Commentator tallies the NASD's total cases concluded during the past three years:

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|---|---|
| 1994 | 4,561 |
| 1995 | 5,680 |
| 1996 | 6,331 |

Securities Arbitration Commentator, Vol. IX No. 3, p. 15 (October 1997).

Of the trend there can be no doubt. As the privatization of dispute resolution continues at its current pace, the important due process safeguards this Court has crafted in *Haslip*, *Honda Motor Company Ltd.* and *BMW of North America, Inc. v. Gore*, ___ U.S. ___, 116 S. Ct. 1589, 134 L. Ed. 2d 809 (1996), risk becoming increasingly irrelevant anachronisms.

It is, perhaps, understandable, given the benefits privatization brings to overcrowded court dockets, if a grateful judiciary is inclined to leave arbitration well enough alone. Why, after all, look a gift horse in the mouth? The answer -- as this case demonstrates -- is that all aspects of privatization are not well. If a crushing financial penalty can be capriciously imposed upon a citizen with no meaningful review, something in the system is broke, and this Court is the only institution that can fix it.

If it fails to do so, confidence in the arbitration process will erode, discouraging participation in arbitration and thus defeating the pro-arbitration policies endorsed by this Court. *See, e.g., Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 105 S. Ct. 1238, 84 L. Ed. 2d 158 (1985), and *McMahon*, 482 U.S. 220.

This Court moved broker/customer disputes from the courts into arbitration with a trio of cases which first disapproved, then overruled its earlier prohibition against arbitration of securities claims, established by *Wilko v. Swan*, 346 U.S. 427, 74 S. Ct. 182, 98 L. Ed. 168 (1953). The three cases, decided in four years, *Byrd*; *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 107 S. Ct. 2332, 96 L. Ed. 2d 185 (1987); and *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 109 S. Ct. 1917, 104 L. Ed. 2d 526 (1989), have moved virtually all customer/broker disputes from court to arbitration.

As it happened, this Court assuaged the fears of anxious litigants now compelled into arbitration. It provided this assurance in *McMahon*:

> Ordinarily, "[b]y agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum."

482 U.S. at 229-30, 107 S. Ct. at 2339, and, later:

> Likewise, we have concluded that the streamlined procedures of arbitration do not entail any consequential

> restriction on substantive rights. [Citation omitted.] Finally, we have indicated that there is no reason to assume at the outset that arbitrators will not follow the law; although judicial scrutiny of arbitration awards necessarily is limited, such review is sufficient to ensure that arbitrators comply with the requirements of the statute.

*Id.* at 232, 107 S. Ct. at 2340.

Similarly, in the concluding paragraph of its opinion, the majority in *Rodriguez de Quijas* justified its decision by proclaiming that the rights of citizens would be protected in the arbitration process:

> Our conclusion is reinforced by our assessment that resort to the arbitration process does not inherently undermine any of the substantive rights afforded to petitioners under the Securities Act.

490 U.S. at 485-86, 109 S. Ct. at 1922.

As Mr. Barnes' experience demonstrates, where punitive damages are involved, this Court's prophesies of procedural fairness are not borne out by experience.

If this Court is to protect the high ideals it professed when rerouting litigation into private dispute resolution, then this Court must actively exercise its supervisory authority over what is on its way to becoming this nation's most important forum for dispute resolution. Through *Byrd, McMahon, Rodriguez de Quijas,* and most recently,

*Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 115 S. Ct. 1212, 131 L. Ed. 2d 76 (1995), and *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 115 S. Ct. 1920, 131 L. Ed. 2d 985 (1995), this Court has not only brought securities litigants into arbitration, but provided meaningful guidance on the conduct of securities arbitrations. The job, however, is not done. To this question we need an answer: In arbitration, must there be due process protection against the capricious or unsound imposition of punitive damages awards?

### C. If this Nation's 500,000 Brokers Are To Be Subjected to the Prospect of Unreviewable, Ruinous Punitive Damages Awards through Securities Arbitration, at Least They Should be Informed of the Danger by the Nation's Highest Court

There are over 505,000 registered securities professionals and 5,400 securities firms with over 58,000 branch offices that are members of the NASD (NASD Website www.NASD.com). By contrast, the entire population of the United States in 1790 was only 3,929,214. Statistical Abstract of the United States GPO, U.S. Dep't of Commerce, Bureau of the Census, 1996, p. 8. It is therefore not unreasonable to assume that the drafters of the Due Process Clause would have found their number significant and would have been concerned if a government-sanctioned, government-controlled organization could then have inflicted large, unreviewable financial punishments upon so many of its citizens.

The Ninth Circuit approach creates an intolerable injustice for the injustice visited upon individual NASD members who are subjected to virtually unreviewable punitive damages claims. Although those who sign on to

become stockbrokers have clear notice of a disciplinary system which, subject to multiple stages of review, can sensor, fine, suspend or bar them, as Justice Thomas pointed out dissenting in *Mastrobuono*, the words "punitive damages" do not even appear in the NASD Code:

> The majority cannot find a provision of the NASD Code that specifically addresses punitive damages, or that speaks more generally to the types of damages arbitrators may or may not allow. Such a rule simply does not exist.

514 U.S. at 69, 115 S. Ct. at 1221. The NASD Code provides no notice that, unlike the carefully structured NASD disciplinary procedures, there is effectively no review of a punitive damages award, no matter what its size, when rendered against an individual broker.

The consequences are harsh indeed. Here, the punitive damages award against Mr. Barnes was for a quarter of a million dollars. Judgments for fraud are nondischargeable under § 523 of the United States Bankruptcy Code, and arbitration awards can create a collateral estoppel. See Restatement (Second) of Judgments § 84 (1982). It is thus possible under the NASD Code that a three-member panel, which includes no lawyer, can impose upon a citizen a crushing, nondischargeable, interest-accruing debt which will, in practical effect, condemn its victim to a lifetime of poverty. This is a far cry from this Court's promise in *Rodriguez de Quijas* and *McMahon* that the substantive rights of parties to arbitrations would be protected. See discussion pp. 18-19, *supra*. This case provides that opportunity.

## CONCLUSION

The Petition for Writ of Certiorari should be granted, and this case remanded to the Ninth Circuit with instructions that the punitive damages award against Mr. Barnes should be subjected to the close scrutiny of punitive damages awards required by the Due Process Clause of the United States Constitution.

RESPECTFULLY SUBMITTED, December 1997.


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